MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

EMS Membership Benefits UK Economy

Despite former Prime Minister Margaret Thatcher's fears that entering the pound into the exchange rate mechanism of the European Monetary System (EMS) would spell economic disaster, one year after entry it appears that sterling's membership in the European Community's currency grid has proved to be more beneficial to the UK economy than even its strongest supporters had hoped. For although the economy is still in recession, largely the result of the Thatcher government's stop-go monetary policies of the late 1980s, inflation and interest rates are down from a year ago, the pound is stable on the foreign exchange markets and signs that the recession may be ending are beginning to appear.

One of the major reasons that Mrs. Thatcher resisted joining the EMS for 11 years was her unwillingness to relinquish control of UK monetary policy to the Bundesbank. Yet, by anchoring the pound to the mark through EMS membership, the Bank of England has been able to engineer eight cuts in UK interest rates during the past year, bringing British base rates from a peak of 15 percent just before the pound entered the EMS last October to 10½ percent, their lowest level in over three years.

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It is extremely doubtful that such a dramatic cut in interest rates would have been possible had sterling not been in the EMS. This is because, without the government's commitment to defend the pound's trading ranges against the other EMS currencies, such a substantial drop in interest rates would have almost certainly provoked a sterling selloff in the foreign exchange markets, especially during a period of Bundesbank monetary tightening.

Interest Rates and Inflation Are Down

Indeed, one sign of the foreign exchange markets' new-found confidence in the pound is the significant narrowing of UK-German interest rate differentials during the past year. The spread between UK base rates and the market-influenced German Lombard rate is at a historically low 1¼ percentage points, while the gap between Euro-sterling and Euro-mark interest rates is now a mere one percentage point versus 6½ percentage points a year ago.

Source: MH

What is more, this has occurred with very little slippage of sterling against the mark: The pound entered the EMS at 2.95 marks per pound and is currently trading at around 2.92 marks per pound, well above its permitted "floor" of 2.778 marks per pound. Indeed, once nicknamed the "whipping-boy of Europe" because of its extreme volatility, the pound has remained pretty much within the standard 2¼ percent EMS trading band against the mark, despite the six percent limits that were granted to the United Kingdom as a transitional step (see chart).

The substantial fall in UK interest rates over the past year, however, would not have been possible without a significant decline in the country's inflation rate. Here, too, EMS membership has played an important role. For one thing, companies are being forced to resist hefty salary demands because they can no longer count on currency devaluation to boost exports as a way of offsetting higher wage costs. For another, sterling's relatively high EMS entry level of 2.95 marks per pound has held down the cost of imports. To be sure, falling mortgage rates, which are included in the retail price index (equivalent to the consumer price index in the United States), have played a major role in reducing the inflation rate, but moderating wage settlements and a strong currency have also helped to alleviate price pressures. As a result, the inflation rate slowed from 10.9 percent last October (year-over-year) to 4.7 percent in August, its slowest pace in three years. In fact,

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there is a good chance that the UK inflation rate, already below the European Community average of 4.9 percent, will be below Germany's within the next few months for the first time since 1969.

What's more, despite complaints from exporters about sterling's high EMS entry level, foreign sales reached a monthly record of 9.1 billion UK pounds in August. Relatively good export performance, combined with compressed import demand due to the recession, is expected to cause the current account deficit to narrow to around seven billion pounds this year from almost 12 billion pounds in 1990.

Finally, signs that the recession may be ending are beginning to appear. In particular, according to the latest monthly trends survey by the Confederation of British Industry (CBI), for the first time in 16 months a majority of UK manufacturers, encouraged by a pickup in both domestic and foreign orders, now expect output volumes to improve in the coming months.

But The Tories Lag In The Polls

So with interest rates down, inflation slowing, the pound stable on the foreign exchange markets, the external accounts improving and signs of economic recovery beginning to surface, why is the ruling Tory Party trailing the opposition

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/18/91)	180,714	- 2,330	- 28,479
New York City (9/25/91)	29,762	- 100	- 5,851
Commercial Paper (9/25/91)	532,877	+ 798	- 30,330

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/18/91)	300,384	+ 1,928	- 18,044
New York City (9/25/91)	53,247	- 1,666	- 3,629

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/18/91)	1,017,929	+ 3,530	- 3,678
New York City (9/25/91)	170,658	- 416	- 7,762

Financial Markets

	Friday 10/4/91	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.14%	- .12	- 2.12
180-Day Bills†	5.27	- .07	- 2.15
Longest Bills†	5.32	- .09	- 2.17
Recent Issues:			
6⅛s 9/30/93	5.90	- .09	
7s 9/30/96	6.79	- .15	
7⅞s 8/1/01	7.39	- .09	
8⅛s 8/15/21	7.79	- .03	
Municipals:			
Bond Buyer—20 Bond Index* (10/3/91)	6.64%	- .09	- .84
Blue List Total ($ Million)	$1,293	- $216	+ $222
30-Day Visible Supply ($ Million)	$2,387	+ $214	+ $536
Total	$3,680	- $ 2	+ $758
Corporates:			
Moody's Aa Composite (10/3/91)	8.79%	- .03	- .96
30-Day Visible Supply ($ Million)	$ 275	- $ 15	- $192
Stocks:			
Dow-Jones Averages:			
Industrials	2,961.76	- 44.28	+451.11
Transportation	1,188.34	+ .75	+322.02
Utilities	212.63	+ 2.19	+ 7.21
65 Stocks	1,062.15	- 7.51	+180.67
N.Y.S.E. Composite Index	210.22	- 1.99	+ 39.52
N.Y.S.E. Avg. Daily Vol. for Week (000's)	163,102	+ 5,030	- 2,189

*34% Taxable equivalent 10.06%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 10/4/91	Week Ago
Overnight	5.25%	5.38%
1 month	5.19	5.38
3 month	5.38	5.56
6 month	5.31	5.56
1 year	5.50	5.69

FOREIGN EXCHANGE SPOT RATES

New York Opening (10/4/91)	Currency Per U.S. $	Week Ago
Belgium	34.25	34.74
Canada	1.1326	1.1352
France	5.6725	5.7455
Germany	1.6642	1.6860
Italy	1245.00	1261.00
Japan	129.70	133.83
Mexico	3061.00	3057.80
Netherlands	1.8747	1.9008
South Korea	730.38	728.01
Switzerland	1.4550	1.4683
Taiwan	26.15	26.26
U.K.*	1.7510	1.7303

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (10/4/91) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	-0.7%	-11.7%

Labor Party in public opinion polls less than nine months before the next general election must be held? The main reason is that despite the recent improvement in economic fundamentals and Prime Minister John Major's personal popularity, the average UK voter apparently does not think that the Tory Party has done a good job in managing the UK economy since its last mandate in 1987. In fact, according to a recent survey, most voters feel that the Labor Party would do a better job than the Tories in such areas as health, education, the environment, living standards and especially employment, some of the exact same issues that Americans are finding fault with George Bush.

Just as in the United States, the fear of unemployment is the main factor dampening consumer confidence, hurting retail sales and thus delaying economic recovery. In the United Kingdom, too, white collar workers have been hard-hit by this recession, causing the Tory Party to concede that unemployment will play a larger role in this election than before. So with 2.4 million UK workers out of a job—and the number is rising—and without such foreign policy distractions as the Middle East and nuclear disarmament to boost their popularity, the Tories may very well find themselves out of office next year for the first time since 1979.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 10/2/91	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	264.169	+ .235	+21.865
Loans to Depository Inst.	.344	- .078	- .167
Float	.396	- .183	- .908
Total Reserve Bank Credit	296.150	+ .102	+10.838
Treasury Deposits with Federal Reserve Banks	8.398	- 1.510	+ .697
Currency in Circulation	293.582	- .113	+21.234
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	249.699	- 2.295	+13.026
Member Bank Reserves:	10/2/91		
Total Reserves Held	50.192	- 1.970	- 9.092
Excess (Deficiency)	1.099	+ .380	- .023
Net Free Reserves	.757	+ .370	+ .142

Monetary Aggregates †		‡ % Change Since 3 Months Ago*	‡ % Change Since Year Ago
M1 (9/23/91)	870.7	+ 5.6	+ 5.9
M2 (9/23/91)	3,392.7	- 0.8	+ 2.2
M3 (9/23/91)	4,136.7	- 2.8	+ 1.0
Domestic Nonfinancial Debt (2nd Q'91)	10,735.3	+ 4.6	+ 5.0

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 10/4/91	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	5.12%	5.25%	5.33%
* Federal Agencies	5.27	5.32	5.46
* Municipal Notes–High Grade (34% Taxable Equivalent)	6.06	6.44	6.82
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	5.30	5.42	5.45

‡ Finance Company Paper–Prime

5- 14 days	5.20%
15- 29 days	5.20
30- 59 days	5.18
60- 89 days	5.00
90-179 days	5.18
180-239 days	5.25
240-270 days	5.25

‡* Bankers' Acceptances

Nov.	5.20%
Dec.	5.20
Jan.	5.28
Feb.	5.25
Mar.	5.25
Apr.	5.20

‡ Industrial Paper–Prime

30- 89 days	5.18%
90-120 days	5.25

†Federal Funds Effective Rate 5.00%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'91	$ 5,612r	$ 5,558	$ 5,443
Gross National Product (1982 Dollars)*	2nd Q'91	$ 4,119r	$ 4,124	$ 4,155
Percent Change, Annual Rate	2nd Q'91	- 0.5r	- 2.8	+ 0.4
Change in Consumer Prices*	Aug '91	2.4%	2.4%	9.6%
Change in MH Cost of Living Index*	Aug '91	4.8%	1.2%	6.0%
Change in Producer Prices*	Aug '91	2.4%	- 2.4%	+ 13.2%
Civilian Employment (Thousands of Persons) †	Sep '91 n	117,165	116,416	117,883
Unemployment as % of Civilian Labor Force †	Sep '91 n	6.7%	6.8%	5.7%
Personal Income*	Aug '91 n	$ 4,824	$ 4,804r	$ 4,675
Leading Indicators Composite Index (1967=100) †	Aug '91 n	145.4	145.4	144.4
Industrial Production Index (1977=100) †	Aug '91	108.2	108.0	110.5
Net Change in Consumer Installment Credit †	Jul '91	- $ 0.84	- $ 1.70	+ $ 2.39
U.S. Merchandise Trade Balance †	Jul '91	- $ 5.90	- $ 3.79	- $ 9.24
Plant and Equipment Expenditures*	4th Q'91	$ 540.9(a)	$ 539.5(a)	$ 529.0
Private Housing Starts (Thousands of Units)*	Aug '91	1,065	1,059	1,131
New Construction Expenditures*	Aug '91 n	$ 406.2	$ 404.9	$ 449.7
Total Business Inventories †	Jul '91	$ 804.5	$ 807.1	$ 818.7
Total Business Sales †	Jul '91	$ 541.0	$ 537.0	$ 541.8

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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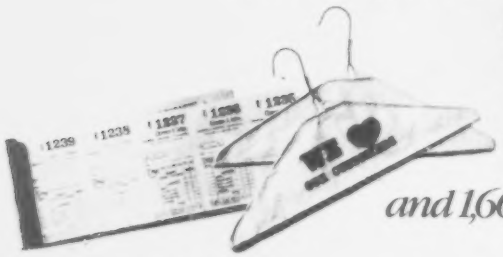

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